International Trade: Business not as Usual

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Background

There are several predictions about the drastic fall in international trade as results of the global negative externality of ongoing pandemic Covid-19. Still we are in the middle of the crisis and do not know the exact span and scale of it. It is thus a difficult task at this moment to ascertain the trend of trade and forecast the exact level and magnitude of impacts of this major event. The impact of COVID-19 on trade has multiple dimensions through interlinked processes. Also, there are significant uncertainties regarding not just the virus itself, but its social and economic impacts as well. The uncertainties made the task of making trade and related policies extremely difficult. This note only outlines some likely impacts based on the limited information presently available on some key trade related variables, anticipating some normalcy in the post-COVID-19 scenario. However, we do not know when such normalcy may return.

The coronavirus hit India in February 2020 via foreign visitors and Indian returnees from abroad. Not surprisingly, it spread from the metros and then through community transmission reached small towns. After WHO declared the virus a global pandemic in mid-March, India went into lockdown on 24 March and all businesses and industries had to close. But the virus gradually migrated to remote areas with the returning migrant workers. But it remains an open question whether the current lockdown has reduced the infection, or it would have been better to delay the lockdown after managing the movements of the migrant workers. It is also unclear if the current lockdown has been utilized to upgrade the medical infrastructure to deal with the pandemic at its peak when it arrives. The economic costs seem to be huge while the fatality is significantly low. Only time will tell if the timing and the scale of the lockdown were correct.

The Impacts Observed So Far in India

Like India, many other countries also adopted lockdown in various forms following their own COVID19 outbreaks leading to serious economic contractions. Global trade virtually came to a standstill and countries virtually coiled themselves into a shell of autarky. This shutdown of the major socio-economic activities along with restriction on movements of people led to sharp contractions in the level of output, household spending, investment and international trade and local level businesses. There are forecasts on India's GDP growth in 2020 to be very close to zero or even negative[1].

The trade is absolutely associated with the production activities, demand-supply and transportation facilities. Almost every country now has cut off the general international travel except emergency rescue operation of stranded people and transaction of ordinary goods too. Only the exchange of essential items like medical related equipment, medicines etc. has been continued. Even the trade on petroleum has come down seriously with reduction in its consumption demand. Due to lockdown, automatically the trade related production activities have been disrupted. The industries are also struggling to survive in this phase due to several socio-economic-administrative measures to control the spread of Covid-19.

The Indian economy already started displaying its dismal picture with stubborn production activities despite slow late charge in the second phase of lockdown. The index of industrial production (IIP) already declined by 16.7 per cent on a y-o-y basis in March 2020. Industrial production in March fell over a base of 2.7 per cent (Ministry of Statistics & Programme Implementation, Govt. of India, 12-05-2020; https://pib.gov.in/PressReleasePage.aspx?PRID=1623300). However, the permission has been given to operate agricultural and allied activities with transportation to harvest the standing matured crops and not to allow it spoil further due to vagaries of weather. Also, some essential industrial operations with limited workforce is allowed due maintaining social distances. Yet the activities continued at very slow pace and there are examples of huge revenue loss to the farmers due to scarcity of worker and for the disrupted transport system. The market linkage for their products has been broken though some spike in price of essential farm products have been observed by the end users in many city areas. The general food inflation has increased to 10.5% in April 2020 (https://pib.gov.in/PressReleasePage.aspx?PRID=1623298)

Major industrial activities and two other sectors like construction and tourism have been completely stopped. But limited construction activities, especially the ongoing government projects have been allowed in the third phase of the lockdown after 3rd May 2020. However, due to lack of supply of raw materials and sudden shortage of labour force with their migration to home villages, the scope of operation has been restricted to a very low scale. The entire tourism and hospitality sector, which was the fastest growing earlier, have now completely stopped. Given that transport, hotels and related businesses employ large number of people, the fear of mass unemployment is now real.

Nomura and Goldman Sachs predict that the Indian economy would contract by 4 percent in the current financial year (during 2020-21) due to the impact of the COVID-19 Pandemic, i.e., growth rate to fall to -0.5% in 2020 and -0.4% in 2021 (*The Economic Times*, May 08, 2020; https://economictimes.indiatimes.com/news/economy/indicators/indian-economy-may-contract-0-4-in-fy21-says-nomura-and-goldman-sachs/articleshow/75629414.cms). Earlier, Moody estimated the growth rate to come down to zero.

Within India trade is also in serious jeopardy owing to the loss of employment and earning, that caused impoverishment and loss of spending capacity of the large number of working-

[1] The Bank of America (BoA) has revised India's real GDP growth projection for 2020-21 downwards to 0.5 per cent as against the earlier estimate of 1.5 per cent as it expects the lockdown to get extended beyond May 2020 (The Economic Times, 12 May, 2020; https://economictimes.indiatimes.com/news/economy/indicators/extra-borrowing-fy21-fiscal-deficit-likely-at-5-8-growth-to-slip-to-0-5-says-report/articleshow/75675256.cms.

class population. Hence, both demand and supply side shocks are clearly visible. That is why Duflo and Banerji (2020) suggested for direct government transfers to those people under social welfare schemes to keep the market alive from demand side.

World Trade Scenario under COVID-19 and After

Earlier, in its 8 April 2020 press release World Trade Organization (WTO) warned that the global merchandise trade is going to contract by 13% to 32% this year due to Covid-19 pandemic[2]. All regions of the world will be hit hard -- a double digit impact everywhere --, but North America and Asia will suffer most. In 2019, total trade of the world stood at about 18.89 trillion US dollars, which was already 0.1% lower in volume terms from 2018 due to the ongoing trade disputes between the US and China, and tensions within the Eurozone economies, notably between the UK and the rest. India also faced a downward trend on its exports, due to US protectionism and its own domestic economic mismanagement affecting competitiveness.

As the Coronavirus has proved to be the deadliest and highly unpredictable, forecast made a month ago might just be obsolete. Nearly half a million people around the world is affected and two hundred eighty thousand dead (as of 10 May), both numbers steadily rising. That means, the WTO forecast may soon have to be revised by the end of the summer, when the devastation in the US and Europe becomes clearer.

Eurozone is going to face its steepest recession in its twenty-year-old history with a 7.7% contraction in GDP[3]. UK will have a 14% recession as per the estimate of the Bank of England, worst in three hundred years, as the second quarter growth has plunged by 25% due to lockdown[4]. Add to this, the combined effect of the diversion of funds from business investment to the health sector, and postponement of all trainings and labour productivity improving activities. US lost all the jobs that it created after the financial crisis of 2008-09 in just over two months with the unemployment count standing at 33 million and growing. There is no official forecast from the US government yet, but IMF has warned on 14 April that there would be a 6% contraction of the US economy in 2020, worst since the Great Depression of 1930s.[5] Gita Gopinath, the Chief Economist of IMF, has said that the world economy is going to *contract* by 3% reversing the expectation of a growth of 3.3% from 2019. That means, a contraction of 6.3% from the potential level. Such is the scale of devastation of just phase one of the Pandemic.

Going forward 2021 offers a much better picture with the hope of recovery, because the current losses have been inflicted by policy induced sudden stoppages and the economies *should* spring back to lives as soon as lockdowns are lifted. But there is a big difference between would and

[2] https://www.wto.org/english/news_e/pres20_e/pr855_e.htm

[3] https://www.ft.com/content/fe444cd7-a501-418f-a3e8-33e4e58fb42c

[4] https://www.ft.com/content/4ec596d9-1db5-4285-87e8-075ff364e262

[5] https://www.nytimes.com/2020/04/14/us/politics/coronavirus-economy-recession-depression.html

should. The global supply chain is fully broken. China seems to be ready to do business, but the rest of the world is in no position to buy from China or from anybody else. It is also abundantly clear now that while the stoppage has been sudden, lifting of lockdown is going to be ten times trickier. By the very spatial nature of contagion, not all regions of a large country -- note China, India, US, Russia, Brazil and EU in this category -- will be contemporaneously infected, and thus will not be equally ready to come out of the lockdown. Peoples will also be reluctant to start engaging in public or to commute to work until they see credible efforts by their governments to track, contain and respond to infections, not to mention the inherent uncertainty of a vaccine coming to our rescue very soon. For developing countries, the problems are monumental.

India's Trade Prospect

Given this grim outlook of severe recessions in major Western economies, India's prospect of goods trade is in complete peril. In 2019, India exported goods worth 324 billion US dollars and imported goods worth 484 billion US dollars -- a clear deficit of $160 billion.

However, one consoling factor for India is that services trade will not suffer in the same way. In 2019, India exported commercial services of $214 billion, of which IT services and call centers constitute a large chunk. India was 8th in the world (in total value) and occupied 3.5% of the global share of the services export. At the same time, India also imported commercial services of $178 billion; this left a modest surplus of $36 billion. However, there is an apprehension of reduced IT sector jobs for Indians in USA (as said by the Trump Administration often to curtail H1B visas for Indians) in the ongoing crisis. It may be possible to mitigate the loss of IT jobs in the US if Europe recovers early and reach out to the Indian market, which is distinct possibility given the growing apathy of the West towards China in the light of the coronavirus.

In this backdrop, India is not in a good shape. An added concern is that many fear India's epidemic is still more than a month away to reach the peak (expected peak time is late June to mid-July), which means India will not be ready to resume its trade (in whatever measure readiness is possible) until October, while its major trading partners will come out of the first phase of the epidemic by June. The second phase will not hit the Northern hemisphere until November, so it seems. So, if India hopes to capture some of China's businesses, that hope may not be well placed, although in one sector India will experience positive gains, that is in pharmaceuticals. It in fact already has, but to increase the potential to capture world market requires huge investment and diversification in such products. There are several countries including India that adopted temporary measures to stop export of selective medical items[6], which could have brought precious foreign exchange to India.

Some steps have been taken towards that direction with an emphasis on small and medium scale export-oriented industries through injection of liquidity, lowering interest rate by RBI and some more relaxations. Till now, Germany, USA and Switzerland are the major exporters of medical products (about 35% of world demand) and China, Germany and the USA together supplies about 40% of personal protective equipment and still there is huge shortage in supply

[6] https://www.wto.org/english/tratop_e/covid19_e/trade_related_goods_measure_e.htm

of pharmaceutical products as per the WTO Report published on 3 April, 2020. But some more steps need to be adopted like the reduction in medical related tariff, which is relatively high in India among trading countries, reduction in GST on pharmaceutical products, which ranges from zero to 18 percent. Even the Ayurvedic products being promoted at present attract 12% GST, which may be lowered at least for some time to encourage diversification towards such items.

Possible Strategy for Trade Recovery

Within India, Maharashtra, Gujarat and Rajasthan are likely to be well past their own peaks, when the Eastern states like Bihar, West Bengal, Assam and Orissa see their initial surges. Thus, regional variations in the surge timing of the infection will make it difficult to have a uniform national strategy. The industries may try to respond by rotating their production around from high- to low-infection regions, and a new type of work substitution may emerge. The re-distributional consequences of such changes are unknown can be hugely upsetting to workers who are tied to their locations. Managing not just the virus and the production chains, but also the discontent of the people will be key to India's recovery.

Apart from already announced interest cut, soft loan and liquidity provisions, some more measures are demanded for recovery by various industrial groups that includes relaxation of labour laws for two-three years with enhanced working hours and preserving minimum wages, cheap power supply etc. But the former would invite scope for exploitation of worker. Also, a question remains is that even if the operations are allowed, whether the workers already returned to remote areas after taking so much trouble will get the confidence to come back and rejoin their duties very soon. The problem is more serious for the informal and small-scale sectors, who could not retain the workers and it seems to take a long time to be on the path of smooth recovery after this COVID-19 induced depression. Further, as De (2020) wrote earlier that just opening selectively one or two sectors would not help much to revive the trade and markets because of the interlinkages and connections across sectors. With strong complementarity these sectors work in unison and move together. The linkages also exist between regions within India, and for international trade, between different regions of the world. So we have to wait for normalcy to return in other parts of the world, where our trading partners reside and they are able to resume their import and export.

Reference

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